



OFFICE OF THE
CITY AUDITOR

**A COMPLIANCE AUDIT OF THE CITY
AND REDEVELOPMENT AGENCY INVESTMENT
PROGRAMS FOR
NOVEMBER AND DECEMBER 1985**

**A REPORT TO THE
SAN JOSE
CITY COUNCIL
FEBRUARY 1986**

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EXECUTIVE SUMMARY

Our review of investment transactions for November and December 1985 indicated that the Finance Department has complied with Policy provisions regarding authorized instruments, maturity limits and issuer rating. Finance has reported all Policy exceptions other than those which require Policy interpretation (see pages 16-19). Finance is implementing procedures to monitor repurchase collateral and is developing the requisite formal agreements for safekeeping, dealer services and repurchase transactions. Appendix A is the Investment Policy as revised on November 12, 1985. Appendix B is an overview of the compliance evaluation.

In addition, we have determined that Finance is taking steps to comply with other prior audit recommendations. Implementation status is discussed in the second chapter of this report. Appendix C is a summary of implementation status.

Finally, we have identified certain Policy areas which require that Finance either obtain legal interpretation or document its own Policy interpretations. Areas requiring clarification are 1) legal requirements for an independent third party custodian 2) legal review of dealer provided master repurchase agreements 3) documentation of Finance Policy

interpretations and 4) identification and analysis of State and Federal laws applicable to the Investment program. These areas are discussed below.

RECOMMENDATIONS

It is recommended that:

Recommendation #1:

Finance obtain a legal opinion to determine requirements for an independent third party custodian for securities involved in City investments. (Priority 2)

Recommendation #2:

Finance incorporate a clause in the proposed City-initiated dealer agreements to supersede any prior service or master repurchase agreements with the dealer. (Priority 2)

Recommendation #3:

Finance document its Policy interpretations. (Priority 2)

Recommendation #4:

Finance prepare a compilation and analysis of State and Federal laws applicable to the investment program. (Priority 2)

LEGAL AND POLICY INTERPRETATIONS NEEDED

Our review of investment transactions for November and December 1985 indicated that the Finance Department has complied with Policy provisions regarding authorized instruments, maturity limits and issuer rating. Finance has reported all Policy exceptions other than those which require Policy interpretation (see pages 16-19). Finance is implementing procedures to monitor repurchase collateral and is developing the requisite formal agreements for safekeeping, dealer services and repurchase transactions. Appendix A is the Investment Policy as revised on November 12, 1985. Appendix B is an overview of the compliance evaluation.

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Finally, we have identified certain Policy areas which require that Finance either obtain legal interpretation or document its own Policy interpretations. Areas requiring clarification are 1) legal requirements for an independent third party custodian 2) legal review of dealer-provided

master repurchase agreements 3) documentation of Finance Policy interpretations and 4) identification and analysis of State and Federal laws applicable to the Investment program. These areas are discussed below.

Safekeeping

Currently, the banks holding the main accounts for the City and the Redevelopment Agency also serve, respectively, as safekeeping agent or custodian of securities involved in investment transactions. These banks also act as dealers in investment transactions for both the City and Redevelopment Agency portfolios. These transactions include purchases of government agency securities, Treasury notes, time deposits, negotiable certificates of deposit (NCD's), bankers acceptances and repurchase agreements. For example, if a repurchase transaction is effected with Bank of America for the Redevelopment Agency portfolio:

1. The bank, acting as Dealer (Trading Department), settles the transaction;
2. The bank, acting as Safekeeping Agent (Trust Department), "receives" securities to be held as collateral for the agreement; and

3. The bank, acting as the Account bank,
releases funds to cover the cost of the
"purchase."

There is currently a great deal of uncertainty regarding proper custodial arrangements among public investors and the banking industry. The uncertainty centers on a definition of "third party" for the purpose of establishing custodial arrangements for securities. The basic premise is that neither the dealer nor an agent of the dealer can serve as an independent third party custodian. Thus, an interpretation can be made that, in instances where a bank is acting as a dealer in a transaction, the bank's Trust Department may not be a sufficiently "independent" third party.

Two factors are primarily influencing the controversy in California. First, the Governmental Accounting Standards Board (GASB) is in the process of developing new reporting standards which contain specific disclosure requirements for investments. Proposed Statement Number 3, as revised and scheduled to be issued March 1986, provides that investments must be categorized by level of safety and disclosed in financial statements. Under the current wording, securities "safekept" by the trust department of a bank which also acts as the dealer in the transaction are classified as higher level of risk.

The basis for this categorization being that there is not a clear legal delineation of the trust department as an entity separate from the financial institution's other departments.

The proposed standards do not prohibit use of a bank trust department or any other type of custodial arrangement, but rather require full disclosure of the GASB-defined level of risk. Specifically, the current wording of the proposed standards states the following (Section 66). The categories are listed in descending order with the highest level of safety first:

"For each type of investment (including repurchase agreements) as of the balance sheet date, the carrying amount and market value should be disclosed in the notes to financial statements ...The carrying amounts should be disclosed in at least the following three categories of credit risk:

- a. Insured ...or registered,... or securities held by the entity or its agent in the entity's name*
- b. Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the entity's name*
- c. Uninsured and unregistered, with securities held by the counterparty, or its trust department or agent but not in the entity's name.*

The term securities as used in this paragraph includes securities underlying repurchase agreements and investment securities.

...The securities are considered registered for this purpose only if registered in the name of the governmental entity."

Second, on October 2, 1985, the Governor signed Senate Bill 115 which amended the California Government Code, Sections 53601, 53635 and 53646, pertaining to repurchase agreements. Following are the Government Code provisions for repurchase agreements. The amended language from SB 115 is underlined:

"The legislative body of a local agency...may invest...in...repurchase agreements or reverse repurchase agreements of any securities authorized by this section, so long as the proceeds of the reverse repurchase agreement are invested solely to supplement the income normally received from these securities. Investment in a reverse repurchase agreement shall be made only upon prior approval of the legislative body of the local agency. For purposes of this section, the term "repurchase agreement" means a purchase of securities by the local agency pursuant to an agreement by which the seller will repurchase such securities on or before a specified date, and for a specified amount and will deliver the underlying securities to the local agency by book entry, physical delivery, or a third-party custodial agreement. The terms of repurchase agreements shall be for one year or less. Such securities, for purpose of repurchase under this subdivision, shall mean securities of the same issuer, description, issue date, and maturity. The term "reverse repurchase agreement" means a sale of securities by the local agency pursuant to an agreement by which the local agency will repurchase such securities on or before a specified date and for a specified amount."

Although the law is silent on the definition of "third party" and the State of California has taken no official position, public Treasurers and banking officials fear that, in instances where the bank is also the dealer, the bank's trust department will not qualify as an independent third party. This interpretation appears to be largely based on the proposed GASB standards. Public Treasurers are proposing legislation to amend the Government Code to make it clear that a trust department can act as the safekeeping agent even when the bank is also acting as the dealer. The State Superintendent of Banks has established a Special Task Force on Local Agency Investments to address this and other issues.

In the meantime, the Federal Reserve Bank (Fed) has announced a decision to allow States and municipalities to directly establish accounts with the Fed for safekeeping of government securities.^[1] The specifics of how this system will be administered are not yet established. It may, however, offer an alternative to the use of banks as safekeeping agents.

[1] Wall Street Journal, "U.S. Moves to Shield Issues Linked to Repos; States, Localities Allowed Fed Accounts to Protect Government Securities," January 22, 1986.

We have requested that Finance obtain legal assistance and consider these factors in establishing their safekeeping agreements.

Master Repurchase Agreements

Finance has indicated a preference to combine the dealer services agreement and master repurchase agreement into one document. Further, Finance has indicated that it prefers not to execute unilateral, dealer-provided agreements.

Additional review of the dealer files maintained by Treasury indicated that three dealer-provided master repurchase agreements have been executed by Treasury as follows:

<u>Dealer</u>	<u>Executed (Date)</u>
Goldman Sachs	December 28, 1983
ACLI Government Securities, Inc. (Kleinwort-Benson)	April 20, 1984
The Morgan Bank	July , 1985

Finance is preparing dealer service agreements which incorporate master repurchase provisions. We have requested

that Finance include in these agreements a clause to supersede any prior agreements executed with the dealer.

Finance Policy Interpretations

In administering the investment program, Finance has applied certain Policy interpretations which are not documented.

We have requested that Finance provide us with its written Policy interpretations for use during the bimonthly investment reviews.

State and Federal Laws

The Investment Policy requires that (emphasis added):

"A. Responsibilities of the Finance Department

The Finance Department is charged by the City Charter with responsibility for maintaining custody of all public funds and securities belonging to or under the control of the City, and for the deposit and investment of those funds in accordance with principles of sound treasury management and in accordance with applicable laws and ordinances."

"B. Responsibilities of the Finance Director

The Finance Director is appointed by the City Manager and is subject to his or her direction and supervision. The Finance Director is charged with responsibility for the conduct of all Finance Department functions, including the custody and investment of City funds, and the development of procedures to implement this Investment Policy. The Finance Director is further responsible for the duties and powers imposed by the general laws of the State of California upon City Treasurers, City Assessors and City Tax Collectors."

Finance does not have a complete compilation and analysis of all laws applicable to the investment program. Accordingly, requisite information to determine compliance is not available for Finance management or Audit staff.

We have requested that Finance prepare a compilation and analysis of all pertinent laws, including codified, published copies of statutes and regulations.

CONCLUSIONS

Finance should 1) obtain a legal opinion regarding an appropriate third party custodian 2) obtain legal review of dealer-provided master repurchase agreements 3) document its Policy interpretations and 4) prepare and update a compilation

of all laws pertinent to the investment program. Such information is necessary for effective program management as well as for third party review.

RECOMMENDATIONS

It is recommended that:

Recommendation #1:

Finance obtain a legal opinion to determine requirements for an independent third party custodian for securities involved in City investments. (Priority 2)

Recommendation #2:

Finance incorporate a clause in the proposed City-initiated dealer agreements to supersede any prior service or master repurchase agreements with the dealer. (Priority 2)

Recommendation #3:

Finance document its Policy interpretations. (Priority 2)

Recommendation #4:

Finance prepare a compilation and analysis of State and Federal laws applicable to the investment program. (Priority 2)

*FOLLOW-UP ON PRIOR
RECOMMENDATIONS*

The City Auditor has developed a number of recommendations to enhance compliance with the City's Investment Policy and improve the City's investment program. Further review indicated that Finance has implemented certain recommendations, while work on others is in progress and requires further follow-up.

Our review indicated that Finance is taking steps to comply with prior audit recommendations. Of the nine recommendations contained in the September 1985 Investment Review, four have been fully implemented and substantial progress has been made on the remaining recommendations. Of the 12 recommendations contained in the October 1985 Investment Review, eleven are in various stages of implementation and one implemented alternative requires further review.

Following is an implementation status report for prior recommendations. An overview chart showing the implementation status of prior recommendations is contained in Appendix C. Recommendations from the September and the October Investment Reviews are grouped into the following categories 1) safety of invested funds 2) policy interpretation and 3) documentation and controls.

Safety of Invested Funds

The Investment Policy contains certain provisions designed to mitigate risk and provide for the safety of invested funds. Instances of non-compliance with certain provisions and requisite recommendations were presented in prior reports. Following is the status of the implementation of these recommendations:

September 1985 Investment Review

Recommendation #7:

Finance complete procedures regarding prequalification of financial institutions. (Priority 1)

Status:

In November, Treasury sent letters to dealers and banks requesting the submission of their most recent financial statements, acknowledgement of the November 1985 Investment Policy Revisions, and a written statement of policy regarding their South African involvement. Responses are now being received and filed. Criteria for the review of the financial

statements is being developed. Finance has targeted March 1, 1986 for implementation of evaluation procedures. A draft service agreement is undergoing legal review. Finance has targeted May 1, 1986 for executing service agreements.

This recommendation is now included in Recommendation #3 of the October Investment Review.

October 1985 Investment Review

Recommendation #1:

Finance comply with Policy requirements to execute formal safekeeping agreements with the City and Redevelopment Agency's Custodial Agents to assure that the City's interest in securities is adequately perfected. (Priority 1)

Status

In January, Finance transmitted a draft safekeeping agreement for legal review. Finance has targeted April 1, 1986 for execution of formal safekeeping agreements. Additional issues relative to safekeeping are discussed on pages 2-7.

Further follow-up is required.

Recommendation #2:

Treasury staff comply with Policy requirements to maintain collateral at 100% of the repurchase agreement's face value, marked-to-market daily, or sufficiently in excess of the agreement's face value. (Priority 1)

Status

Treasury is implementing procedures to monitor repurchase collateral through the MONEymax system. It is anticipated that the system will be in full use by the end of February. In addition, the Treasurer has instructed staff to establish collateral at 102% of the repurchase agreement's face value.

Further follow-up is required.

Recommendation #3:

Finance comply with Policy requirements to establish procedures to evaluate and monitor dealer financial condition and execute formal master repurchase agreements and services agreements with dealers. (Priority 1)

Status

Treasury has targeted March 1, 1986 for implementation of procedures to evaluate dealer financial condition. A draft service agreement, incorporating master repurchase provisions, is undergoing legal review. Finance has targeted May 1, 1986 for execution of service agreements with dealers. In addition, Finance plans to issue RFP's and execute new Banking Services Agreements. For the City, Finance has targeted February 21, 1986 to issue an RFP and May 1, 1986 to execute an agreement. Exact dates for the Redevelopment Agency are pending. Additional information on master repurchase agreements can be found on pages 7-8.

Further follow-up is required.

Recommendation #4:

Treasury establish guidelines for repurchase agreements which 1) allow substitution of securities only on an exception basis, and 2) limit the number of securities used as collateral. Treasury document reasons for exceptions to the guidelines. (Priority 1)

Status

The Treasurer has issued verbal instructions to staff. Written guidelines will be included in revised procedures targeted for completion by March 1, 1986

Further follow-up is required.

POLICY INTERPRETATION

In the October Investment Report, we identified areas that require policy clarification. Following is an update on these recommendations.

Recommendations #5:

Finance obtain clarification from the Private Sector Investment Committee regarding the issues of repurchase agreement collateral, issuer percentages, and financial institution qualifications. (Priority 2)

Status

We have requested that Finance pose the following questions to the Private Sector Panel:

1. Should securities accepted as collateral for a repurchase agreement be restricted to:
 - a. Types of government securities approved for purchase?
 - b. The three year maturity limit for government securities?
2. Should repurchase agreements with dealers be considered when figuring the 10% limit on investments with a single issuer?

Finance plans to meet with the Private Sector Panel in March 1986, prior to Council's annual review (April) of the Investment Policy.

Further follow-up is required.

Recommendation #6:

Finance include in its Monthly Investment Report all investments which do not comply with Policy provisions. Finance should indicate which investments are subject to on-going review for potential sale. (Priority 2)

Status

In the October 1985 Monthly Investment Report, Finance initiated a new practice of reporting investments purchased prior to the April 2, 1984 Investment Policy which do not comply with current Policy provisions. This report cited as exceptions investments which 1) exceeded Policy maturity limits as of the end of October and 2) did not meet Finance "quality" standards.

In response to our recommendation to report all exceptions, Finance agreed to report Student Loan Mortgage Association holdings. However, the City and Redevelopment Agency portfolios still contain investments which do not meet Policy rating and/or location requirements for issuers.

We have asked that Finance provide us with documentation of its Policy interpretations regarding investments purchased

prior to the Policy effective date. These interpretations will be applied during our bi-monthly reviews.

Further follow-up is required.

Documentation and Controls

During our review of investments, we identified certain weaknesses in internal controls. In addition, we determined that Finance does not always maintain adequate documentation for investment transactions. In some instances, Finance does not require the documentation while in other instances, the documentation is required, but not consistently maintained. Such documentation is necessary to facilitate 1) third party review of investment activities 2) day-to-day investment activities, and 3) management oversight of the investment program.

September 1985 Investment Review

Recommendation #1:

Treasury staff utilize MONEYMAX in managing the portfolio and making investment decisions by: running a portfolio profile daily or on each day when purchases, sales or maturities occur; and using the portfolio report in making investment decisions. (Priority 1)

Status

In November 1985, Treasury implemented use of a MONEymax generated daily portfolio profile (GSIOT, Investments Outstanding by Type). This report is maintained in the Treasurer's Office. Manual calculations are noted on the report to assist in maintaining the portfolio within Policy guidelines for category and issuer limits.

The recommendation is implemented.

Recommendation #2:

Treasury staff insure that entry into MONEymax is timely and accurate by: entering the transaction data on the date that the transaction occurs; running machine numbered, logged and dated batch reports for all entries; and reviewing batch reports for accuracy. (Priority 1)

Status:

Under new procedures implemented by Treasury, rough drafts of confirmations are prepared and the data is input into MONEymax, usually on the same day the transaction is authorized. A logged and dated input verification report, a general journal report, an exception report, and the GSIOT

report are run on the same working day the master file is updated. The reports are maintained in the Treasurer's Office and are available for review by outside parties. The MONEymax line number is noted on both the rough draft and the typed confirmation. The typed confirmation is usually submitted to the Chief of Treasury for signature within 24 hours. Some delays occurred in December which may have been due to the holidays.

Further follow-up is required.

Recommendation #3:

Finance enhance staff's ability to utilize MONEymax by: providing comprehensive training for employees in the use of MONEymax; and preparing a simplified instructions manual on the use of MONEymax for Finance employees. (Priority 2).

Status:

A training session took place on December 20, 1985. Finance plans future training sessions, including training to prepare staff for planned upgrades and additional software products.

The MONEYMAX instruction manual is targeted for completion by March 1, 1986.

Further follow-up is required.

Recommendation #4:

Treasury staff advise Finance management of portfolio status on a timely basis by distributing a copy of the portfolio profile report in Recommendation #1 to the Treasurer, Chief of Accounting and the Finance Director. (Priority 1)

Status:

We verified that the Chief of Treasury receives a daily portfolio profile report to review portfolio status. Also, the Chief of Accounting and the Director of Finance receive a daily exception report and a weekly Earned Interest Summary report for their review.

This recommendation is implemented.

Recommendation #5:

Treasury staff prepare revenue vouchers for maturities, sales and interest payments on the date funds are deposited or payment is received. (Priority 1)

Status:

Revenue vouchers for maturities and related interest are generally being prepared on the day following receipt of monies. This timeframe is acceptable.

This recommendation is implemented.

Recommendation #6:

Treasury staff maintain documentation to verify information used each day in making investment decisions, including the portfolio profile report and all cash flow information. (Priority 2)

Status:

A daily portfolio profile is now maintained. (See Recommendation #1).

Treasury and audit staff have agreed on simplified procedures. MONEymax Cash Flow reports will be retained in a binder. The run date of the MONEymax Cash Flow Report and the

date and source of interim information utilized to determine investible funds will be entered on the Daily Cash Flow Sheets.

Further follow-up is required.

Recommendation #8:

Treasury document reasons for sales.

Status:

Treasury staff states that procedures are in place to document the reasons for sales. Since no sales took place in November, we were unable to verify or review these procedures.

Further follow-up will be required as sales transactions occur.

Recommendation #9:

Accounting complete improvements in reconciliation procedures.

Status:

This recommendation was directed at Accounting's "as-received" reconciliation of investment documents. Month-end and year-end reconciliations will be addressed in the investment program performance audit.

The intent of this recommendation is now included in Recommendations 7 and 12 in the review of October transactions.

October 1985 Investment Review

Recommendation #7:

Accounting ensure that safekeeping receipts are promptly received and reconciled. (Priority 1)

Status:

In November, safekeeping receipts for the City portfolio were not properly reconciled. Steps were taken to correct this deficiency in December. Redevelopment Agency portfolio reconciliations were performed in November and December.

Monthly safekeeping reports from the safekeeping agents are being improved.

Further follow-up is required.

Recommendation #8:

Treasury establish data entry standards to ensure the accuracy of MONEymax entry, including adequate issuer identification. (Priority 1)

Status:

Treasury is developing standards and procedures. A MONEymax instruction manual is targeted for completion by March 1, 1986.

Further follow-up is required.

Recommendation #9:

Treasury enter the dealer's name and securities held as collateral for repurchase agreements into the MONEymax system. (Priority 1)

Status:

Treasury is implementing a system to record securities held as collateral for repurchase agreements in the MONEYMAX system. Finance does not concur with the need to enter the name of the dealer ("issuer"). This is a policy interpretation which will be presented to the Private Sector Panel (10% issuer restriction applied to repurchase agreements).

Further follow-up is required.

Recommendation #10:

Treasury document daily investment strategy and purchase decisions.

Status:

Additional documentation began in December. Further review is required as Treasury staff becomes familiar with the procedures.

Recommendation #11:

Treasury segregate the functions of investing funds and receiving investment income. (Priority 1)

Status:

Finance has responded that staffing levels and management preferences preclude reorganization to separate investments from receipt and deposit of investment income. As an alternative, the Treasurer, rather than the Treasury Assistant, approves all investment related revenue vouchers.

This recommendation will remain open for further review.

Recommendation #12:

Finance establish additional procedures to ensure that controls are functioning and written verification of purchases and sales is complete and timely. Specifically, procedures need to be established to 1) monitor compliance with Policy provisions regarding release of funds or securities 2) provide for 24 hour preparation and mailing of confirmations 3) implement pre-numbered and controlled confirmation documents and 4) date stamp and reconcile dealer, safekeeping, debit and credit advices as received. (Priority 2)

Status:

The Control Log for wire transfer of funds was properly initialed in November and December. Finance plans to amend the Investment Policy to allow three working days for transmittal of confirmations. Implementation of pre-numbered confirmation documents is targeted for June 1, 1986 in order that automation of forms through MONEymax can be explored. If the system can generate the confirmations, savings in staff time may result. Accounting is now date stamping all receipts and advices.

Further follow-up is required.

CONCLUSION

Finance is taking steps to comply with recommendations regarding documentation and controls. Some recommendations are fully implemented. Others require further follow-up as implementation occurs and Finance staff become familiar with the procedures.

CITY OF SAN JOSE - MEMORANDUM

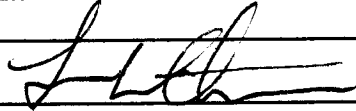
TO: Honorable Mayor and City Council

FROM: Edward G. Schilling
Director of Finance

SUBJECT: RESPONSES TO NOVEMBER/DECEMBER 1985
COMPLIANCE REVIEW

DATE: February 24, 1986

APPROVED



DATE

RECOMMENDATION #1

The current industry concern about third party safekeeping of investment securities is well described in the Audit Report. In response to the same concerns the Treasury Division has not executed repurchase agreements with the bank which safekeeps that portfolio's securities since mid-January. An even more conservative approach would be to discontinue purchasing securities for both portfolios from their respective safekeeping banks. That course of action will be implemented when the new safekeeping and banking services are executed, and will be maintained until the current industry uncertainty on the safekeeping issue is resolved.

Unfortunately, while the Federal Reserve Bank has agreed to provide safekeeping services for states and their political subdivisions, the State of California has not set up the accounting procedures for use of the Federal services, and they question the adequacy of their staff to implement the service if they had the procedures. Even if California were able to offer Federal Reserve Bank safekeeping, it would not handle all of the City's needs because the Federal accounts can only handle government "book-entry" securities. Other types of money market instruments would still have to be safekept by a commercial bank.

The Finance Department is not opposed to seeking a legal opinion on how to guaranty that the City's safekeeping agreement established a true independent third party custodial responsibility. We believe that issue will be addressed in the examination of our proposed safekeeping agreement by legal counsel. We are not confident, however, that a definitive answer will be forthcoming to this complex issue. Until such time as an industry safekeeping standard is developed, we will continue the conservative approach described above.

RECOMMENDATION #2

Finance will include a clause in the master repurchase agreement which indicates that the newly drafted agreement supersedes any documents signed prior to its implementation.

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RECOMMENDATION #3

The Treasury Assistant will document the requested policy interpretations for use during the March/April 1986 review. This will allow enough time to incorporate the input from the Private Sector Panel review which is scheduled for March 1986.

RECOMMENDATION #4

Finance will request legal assistance to compile the reference library described within this recommendation.

Respectfully submitted,



Edward G. Schilling
Director of Finance

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APPENDIX A

CITY OF SAN JOSE
INVESTMENT POLICY

I. STATEMENT OF OBJECTIVES

Temporarily idle or surplus funds of the City of San Jose shall be invested in accordance with principles of sound treasury management and in accordance with the provisions of California Government Code Sections 53600 et seq., the Charter of the City of San Jose, the Municipal Code, and this Investment Policy.

A. Overall Risk Profile

The basic objectives of San Jose's investment program are, in order of priority:

1. Safety of invested funds;
2. Maintenance of sufficient liquidity to meet cash flow needs; and,
3. Attainment of the maximum yield possible consistent with the first two objectives.

The achievement of these objectives shall be accomplished in the manner described below:

1. Safety of Invested Funds

The City shall insure the safety of its invested idle funds by limiting credit and interest rate risks. Credit risk is the risk of loss due to the failure of the security issuer or backer. Interest rate risk is the risk that the market value of portfolio securities will fall due to an increase in general interest rates.

a. Credit risk will be mitigated by:

- 1) Limiting investments to the safest types of securities;
- 2) By pre-qualifying the financial institutions with which it will do business;
- 3) By diversifying the investment portfolio so that the failure of any one issuer or backer will not place an undue financial burden on the City; and
- 4) By monitoring all of the City's investments on a daily basis to anticipate and respond appropriately to a significant reduction of creditworthiness of any of the depositories.

b. Interest rate risk will be mitigated by:

- 1) Structuring the City's portfolio so that securities mature to meet the City's cash requirements, thereby avoiding the need to sell securities on the open market prior to their maturation; and
- 2) Investing primarily in shorter-term securities, unless it is anticipated that long-term securities can be held to maturity without jeopardizing liquidity requirements.

c. The physical security or safekeeping of the City's investments is also an important element of safety. Detailed safekeeping requirements are defined in Section III of this Policy.

2. Liquidity

The City's investment portfolio must be structured in a manner which will provide that securities mature at the same time as cash is needed to meet anticipated demands (static liquidity). Additionally, since all possible cash demands cannot be anticipated, the portfolio should consist largely of securities with active secondary or resale markets (dynamic liquidity). The specific percentage mix of different investment instruments and maturities is described in Section II of this Policy.

3. Yield

Yield on the City's investment portfolio is of secondary importance compared to the safety and liquidity objectives described above. Investments are limited to relatively low-risk securities in anticipation of earning a fair return relative to the risk being assumed. While it may occasionally be necessary for the City to sell a security prior to maturity to meet unanticipated cash needs, this Policy specifically prohibits trading securities for the sole purpose of realizing trading profits. Specifically, "When, as, and if issued" trading is prohibited.

B. Time Frame for Investment Decisions

The City's investment portfolio shall be structured to provide that sufficient funds from investments are available every month to meet the City's anticipated cash needs. Subject to the safety provisions outlined above, the choice of investment instruments and maturities shall be based upon an analysis of anticipated cash needs, existing and anticipated revenues, interest rate trends and specific market opportunities. As a general rule, the average maturity of the investment portfolio will not exceed 18 months, and no investment will have a maturity of more than three years from its date of purchase.

C. Definition of Idle or Surplus Funds

Idle or surplus funds for the purpose of this Policy are all City funds which are available for investment at any one time, including the estimated checking account float, excepting those minimum balances required by the City's banks to compensate them for the cost of banking services. This Policy also applies to the idle or surplus funds of other entities for which City of San Jose personnel provide financial management services.

D. Limitations on Reverse Repurchase Agreements

Under no circumstances shall the City borrow funds through reverse repurchase agreements for the purpose of financing the acquisition of securities. Except as otherwise authorized by the City Council, the use of reverse repurchase agreements will be limited to those occasions where unanticipated, short-term cash requirements can be met more advantageously by initiating a reverse repurchase agreement than by selling a security prior to its maturity. (For example, if a specific cash requirement precedes the maturity of a security which had been intended to meet that requirement, it may be advantageous to initiate a reverse repurchase agreement pledging the security as collateral, rather than selling the security prior to its maturity. Proceeds from the maturity of the security would then be used to close out the reverse repurchase agreement.) The term of any reverse repurchase agreement shall be limited to one month; the amount of the agreement may not exceed \$25 million, and only a single agreement shall be in effect at one time. Prior written approval by the City Manager or his designee is required to enter into a reverse repurchase agreement, and the fact that such a reverse repurchase agreement has been executed will be reported to the City Council.

II. INVESTMENTS

This section of the Investment Policy identifies the types of instruments in which the City will invest its idle funds.

A. Eligible Securities

The City may invest temporarily idle funds through banks, savings and loans, securities dealers, and the State Local Agency Investment Fund (LAIF).

The following table summarizes the authorized investment instruments, and applicable limitations on each.

<u>TYPE</u>	<u>LOCATION</u>	<u>DOLLAR LIMITS</u>	<u>MATURITY</u>
1. Category One:			
Local Agency Investment Fund	California	Maximum \$5mm	On demand

<u>TYPE</u>	<u>LOCATION</u>	<u>DOLLAR LIMITS</u>	<u>MATURITY</u>
Insured deposits - Banks and S&L's	San Jose(1) Area	NTE(2) \$10mm	NTE 3 Years
U.S. Treasury Bonds Notes and Bills	-	No Limit	NTE 3 Years
U.S. Government Agency Issues	-	No Limit	NTE 3 Years
2. Category Two:			
Repurchase Agreements	Banks and Reporting Dealers	No Limit	NTE 10 Days
Reverse Repurchase Agreement(3)	Banks and Reporting Dealers	NTE \$25mm	NTE 30 Days
Time Deposits-Banks	San Jose Area))) 30%	NTE 18 Months
Time Deposits-Savings & Loan	San Jose Area))	NTE 18 months
3. Category Three			
Bankers Acceptances	Domestic U.S.)))	NTE 6 Months
Commercial Paper	Domestic U.S.) 30%))	NTE 6 Months
Negotiable Certificates of Deposit	Domestic U.S.))	NTE 6 Months
(1) Exceptions to this limit may be required to maintain deposits in minority-owned banks consistent with San Jose's voluntary participation in HUD's Minority Banking Program.			
(2) NTE = Not to exceed			
(3) Subject to limits in Section I. D. of this Policy.			
4. No more than 10% of the total portfolio shall be invested in the issuances of any single institution other than securities issued by the U.S. Government and its affiliated agencies. Additionally, no more than 5% of the total portfolio shall be invested in the uninsured-uncollateralized issuances of any single institution.			

B. Qualification of Brokers, Dealers and Financial Institutions

Aside from LAIF, insured deposits, and U.S. Treasury and Government Agency issues, investments shall be placed only in those instruments and institutions rated favorably by the Keefe, Bruyette and Woods Bank and Savings and Loan Rating Service or Moody's Commercial Paper Record. For Banker's Acceptances depositories shall be limited to banks and savings and loans rated "B" or better, and selected major California banks rated "C" or better. For Negotiable Certificates of Deposit, depositories shall be limited to banks and savings and loans rated "A" or better by Keefe, Bruyette and Woods. Except for insured deposits in California banks and savings and loans, City investment transactions will be conducted only with institutions meeting the tests described above, and/or with dealers from the list of Government Security dealers reporting to the Market Reports Division of the Federal Reserve Bank of New York (Exhibit A) and/or with dealers from the list of Commercial Paper dealers reporting to the Market Reports Division of the Federal Reserve Bank of New York (Exhibit B). Except for investment in Banker's Acceptances and Negotiable Certificates of Deposit, the City will limit its investments in banks and savings and loans to those institutions maintaining offices in the San Jose area.

The purchase of Government Agency securities will be limited to issues of the Federal Farm Credit Bank, the Federal Home Loan Bank, and the Federal National Mortgage Association. Other government agency securities lack the liquidity which the City's portfolio requires, and are therefore inappropriate for purchase.

The California Government Code restricts cities to investing in commercial paper of the highest rankings provided for by Moody's Investment Service or Standard and Poor's. Issuing corporations must be organized and operating within the United States and have total assets in excess of \$500,000,000, and an "A" or higher rating for the corporation's own indebtedness other than commercial paper. The City may not hold more than 10% of an issuing corporation's commercial paper.

C. Collateralization Requirements

All repurchase agreements and all time deposits over \$100,000 shall be collateralized. The collateral for repurchase agreements shall be U.S. Treasuries or Government Agency issues, if available, whose market value at the time of purchase is equal to 100 percent of the repurchase agreement's face value. For other than overnight investments the required collateral for repurchase agreements shall be marked to market on a daily basis and maintained at an amount equal to 100 percent of the repurchase agreement's face value. Alternatively, the amount of collateral provided for the repurchase agreement may be set at a value sufficiently in excess of the repurchase agreement's face value to protect against a sudden decrease in the collateral's value.

Uninsured time deposits with banks and savings and loans shall be collateralized in the manner prescribed by law for depositories accepting municipal investment funds.

D. Pre-formatted Wire Transfers

Wherever possible, the City will use pre-formatted wire transfers to restrict the transfer of funds to pre-authorized accounts only. When transferring funds to an account not previously approved, the bank is required to call back a second employee for confirmation that the transfer is authorized.

E. Requirement for Financial Statements

Each bank, savings and loan and security dealer, otherwise qualified under the provisions of this policy, who wishes to do business with the City shall submit a copy of its latest financial statement to the City including a balance sheet and profit and loss statement. After a review of the financial statement and all other relevant information, the City will determine whether a service agreement should be executed with the institution based on the standards outlined in this Policy. The City requires that an agreement for services be executed prior to entrusting its funds to any dealer or financial institution, and that up-to-date financial statements be sent to the Director of Finance upon their issuance.

F. Notice to Dealers

The City shall annually send a copy of the current edition of this Investment Policy to all institutions which are approved to handle City of San Jose investments. Receipt of the Policy, including confirmation that it has been reviewed by persons handling the City's account, shall be acknowledged in writing within thirty days.

III. SAFEKEEPING OF SECURITIES

A. Safekeeping Agreement

The City shall contract with a bank or banks for the safekeeping of securities either owned by the City as part of its investment portfolio or held as collateral to secure time deposits or repurchase agreements.

B. Handling of City-Owned Securities and Time Deposit Collateral

All securities owned by the City shall be held by its safekeeping agent, except the collateral for time deposits in banks and savings and loans. The collateral for time deposits in savings and loans is held by the Federal Home Loan Bank. The collateral for time deposits in banks is held in the City's name in the bank's trust department (if a safekeeping agreement has been executed) or, alternatively, in the San Francisco Federal Reserve Bank.

C. Handling of Repurchase Agreement Securities

The securities which serve as collateral for repurchase agreements with banks may be held in the issuing bank's trust department, provided that a master trust agreement has been executed insuring fiduciary separation of these assets from other bank assets. The securities which serve as collateral for repurchase agreements with dealers must be delivered to a third-party custodian with which the City has established a safekeeping agreement.

D. Security Transfers

The authorization to release City securities will be telephoned to the appropriate bank by a Treasury staff member other than the person who initiated the transaction. A written confirmation outlining details for the transaction and confirming the telephoned instructions will be sent to the bank within 24 hours.

E. Verification of Security

The collateral being held in safekeeping for the City will be verified in writing and examined on a surprise basis during the year. Verification of collateral will be part of the City's annual independent audit.

IV. STRUCTURE AND RESPONSIBILITY

This section of the Investment Policy defines the overall structure of the investment management program.

A. Responsibilities of the Finance Department

The Finance Department is charged by the City Charter with responsibility for maintaining custody of all public funds and securities belonging to or under the control of the City, and for the deposit and investment of those funds in accordance with principles of sound treasury management and in accordance with applicable laws and ordinances.

B. Responsibilities of the Finance Director

The Finance Director is appointed by the City Manager and is subject to his or her direction and supervision. The Finance Director is charged with responsibility for the conduct of all Finance Department functions, including the custody and investment of City funds, and the development of procedures to implement this Investment Policy. The Finance Director is further responsible for the duties and powers imposed by the general laws of the State of California upon City Treasurers, City Assessors and City Tax Collectors.

C. Responsibilities of the City Manager

The City Manager is responsible for directing and supervising the Director of Finance. He or she is responsible further to keep the City Council fully advised as to the financial condition of the City.

D. Responsibilities of the City Auditor

The City Auditor is charged by the City Charter with a continuing post audit of all the fiscal transactions of the City including, but not limited to the examination and analysis of fiscal procedures and the examination, checking and verification of accounts and expenditures. A review of the City's investment program is a part of the responsibility described above. The City Auditor will develop a written audit program containing the audit procedures to be performed.

E. Responsibilities of the City Council

The City Council shall consider and adopt a written Investment Policy. As provided in that Policy, the Council shall receive, review, and accept monthly Investment Reports.

F. Responsibilities of the Internal Investment Committee

There shall be an Internal Investment Committee consisting of the City Manager, the Director of Finance, the Chief of Treasury, the Chief of Accounting, and a private sector investment expert named by the Mayor. The Committee shall meet monthly to discuss the Monthly Investment Reports, investment strategy, investment and banking procedures and significant investment-related work projects being undertaken in the Finance Department. The Committee's meetings will be summarized in minutes which are distributed to the City Council.

V. REPORTING

The Director of Finance shall prepare a monthly Investment Report, including a succinct management summary that provides a clear picture of the status of the current investment portfolio and significant transactions made over the past month. This management summary will be prepared in a manner which will allow the City Manager and City Council to ascertain whether investment activities during the reporting period have deviated from the City's Investment Policy.

The monthly Investment Report will include the following:

- A. Trend of average portfolio maturity;
- B. Maturity aging by type of investment;
- C. Percentage mix of portfolio by type of investment including a listing of individual securities held at the end of the reporting month;

- D. Portfolio turnover rate and trend;
- E. Separation of realized trading gains or losses from interest received on trading activity; (Since the City is not involved in active trading, this will occur only when a security must be sold prior to maturity because of unanticipated cash needs.)
- F. Reasons for and amounts of violations or exceptions to the investment policy during the month being reported on, as well as prior violations or exceptions which have not yet been corrected;
- G. Trend of rate of return on investments;
- H. Unrealized gain or loss resulting from appreciation or depreciation in the market value of securities;
- I. Aggregate commitments to purchase securities or make other payments to dealers in a manner to permit adequate cash need forecasting;
- J. Interest cost and interest earnings from reverse repurchase agreement transactions.
- K. All investment transactions occurring during the month whether or not the transaction has been fully settled.
- L. A description of the current investment strategy and the assumptions upon which it is based.
- M. Average rate of return on reporting month's purchases.
- N. Average rate of return on reporting month's sales and/or maturities.
- O. Distribution reports by bank and broker/dealer.

VI. REVIEW OF INVESTMENT MANAGEMENT

A. Policy Exceptions

While this Policy prescribes various maximums, minimums and other relatively arbitrary numerical limits, it is intended primarily to be a management tool. When the Director of Finance determines that an exception to one of the Policy's numerical limits is in the best interest of the City, and is otherwise consistent with the Investment Policy, such exception is permitted so long as it is consistent with applicable City, State and Federal laws. Whenever an exception or violation of this Policy is made that fact shall be reported to the City Manager and the City Council within one business day of its discovery. Major exceptions will be reported immediately. All exceptions to the Policy and the appropriate explanation or justification for the exception shall be reported verbally to the Finance Committee at its next regular meeting and included in the Monthly Investment Report.

B. Policy Review

This Investment Policy shall be reviewed annually to ensure its consistency with respect to the overall objectives of safety, liquidity and yield, and its relevance to current laws and financial trends. Proposed amendments to the Policy shall be prepared by the Director of Finance, and after review and approval by the City Manager, shall be forwarded to the City Council for consideration and approval.

4265F/0225F
Rev. 11/85

Commercial Paper Dealers Reporting
to the Market Reports Division of the
Federal Reserve Bank of New York

Ashwell & Company

The First Boston Corporation

Goldman Sachs & Company

Lehman Commercial Paper, Inc.

Merrill Lynch Money Markets, Inc.

Morgan Stanley & Company, Inc.

Paine, Webber, Jackson & Curtis, Inc.

Piper, Jaffray & Hopwood, Inc.

Salomon Brothers

5295F/0263F

LIST OF THE GOVERNMENT SECURITIES DEALERS REPORTING TO THE MARKET REPORTS DIVISION
OF THE FEDERAL RESERVE BANK OF NEW YORK

Bank of America NT & SA
 Bankers Trust Company
 Bear, Stearns & Company
 Briggs, Schaedle & Company, Inc.
 Carroll McEntee & McGinley Incorporated
 Chase Manhattan Government Securities, Inc.
 Chemical Bank
 Citibank, N.A.
 Continental Illinois National Bank
 and Trust Company of Chicago
 Crocker National Bank
 Discount Corporation of New York
 Donaldson, Lufkin & Jenrette Securities
 Corporation
 Drexel Burnham Lambert Government Securities, Inc.
 The First Boston Corporation
 First Interstate Bank of California
 First National Bank of Chicago
 Goldman, Sachs & Company
 Greenwich Capital Markets, Inc.
 Harris Trust and Savings Bank
 E. F. Hutton & Company, Inc.
 Kidder, Peabody & Company, Inc.
 Kleinwort Benson Government Securities, Inc.
 Aubrey G. Lanston & Company, Inc.
 Lehman Government Securities, Inc.
 Manufacturers Hanover Trust Company
 Merrill Lynch Government Securities, Inc.
 Morgan Guaranty Trust Company of New York
 Morgan Stanley & Company, Inc.
 The Northern Trust Company
 Paine Webber Incorporated
 Wm. E. Pollock Government Securities, Inc.
 Prudential-Bache Securities, Inc.
 Refco Partners
 Salomon Brothers, Inc.
 Smith Barney Government Securities, Inc.
 Dean Witter Reynolds Inc.

NOTE: This list has been compiled and made available for statistical purposes only and has no significance with respect to other relationships between dealers and the Federal Reserve Bank of New York. Qualification for the reporting list is based on the achievement and maintenance of reasonable standards of activity.

Market Reports Division
 Federal Reserve Bank of New York
 September 12, 1984

5296F/0263F

SOUTH AFRICA-FREE INVESTMENT POLICY

1. STATEMENT OF OBJECTIVES

In addition to the guidelines and restrictions outlined in the City of San Jose Investment Policy, the temporarily idle or surplus funds of the City shall be invested in a manner which complies with the intention of the City Council Minute Order passed June 11, 1985, establishing a South Africa-free restriction on the investment portfolio.

2. IMPLEMENTATION OF RESOLUTION

Effective upon adoption, no new investments will be placed in any of the following:

- a) Securities issued by the Republic of South Africa.
- b) Securities issued by South African corporations.
- c) Securities of U. S. corporations with South African subsidiaries.
- d) Banks which invest in or do business with the Republic of South Africa or its corporations.
- e) Banks which make loans to U. S. corporations in support of the activities of their South African subsidiaries.

Compliance with this policy shall be determined by examining a bank's written statement of policy regarding its South African involvement or non-involvement. For those securities issued by corporations other than banks, the most recent information available from the Investors Responsibility Research Center or a similar source shall be used to determine whether the firm is operating in South Africa. It is recognized that lists of businesses operating in South Africa cannot be updated on a timely basis due to the dynamics of the environment.

3. TIME FRAME FOR DIVESTMENT OF INVESTMENTS IN VIOLATION

The Treasury Division will monitor the market values of these investments and the instruments will be sold if and when it is profitable.

4. REPORTING

Compliance with the restrictions imposed by the Council Resolution will be monitored by the Chief of Treasury and will be reported monthly in the Investment Report prepared by the Director of Finance for distribution to the City Council.

Non-compliance with these restrictions will be considered a violation of the Investment Policy and will be reported as a violation in the monthly Investment Report prepared by the Director of Finance.

5064F/0263F

APPENDIX B

SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF NOVEMBER 1985 AND DECEMBER 1985 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?	
	November	December
	<u>1985</u>	<u>1985</u>
A. PREQUALIFICATION OF DEALERS		
1. Is the Dealer (1) on the list of Government Security Dealers Reporting to the Market Reports Division of Federal Reserve, or does the dealer meet the required Keefe, Bruyette and Woods rating?	YES	YES
2. Has the Dealer or Bank filed an acknowledgement of receipt and review of the City's Investment Policy with Treasury?	YES	YES
3. Have Financial Statements been filed with Treasury?	NO	NO
4. Do the Financial Statements include a Balance Sheet and a Profit and Loss Statement?	NO	NO
5. Are the Financial Statements current?	NO	NO
6. Has Treasury reviewed the Financial Statements?	NO	NO
7. Has a Services Agreement been executed?	NO	NO

(1) Includes banks and savings and loans acting as dealers. Treasury accepts a Keefe, Bruyette and Woods rating of "B", or "C" for selected major California banks, in lieu of primary dealer status for banks and savings and loans.

APPENDIX B

SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF NOVEMBER 1985 AND DECEMBER 1985 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?	
	<u>November 1985</u>	<u>December 1985</u>
B. PROVISIONS APPLYING TO ALL PURCHASES		
1. Purchase is of an approved instrument?	YES	YES
2. Purchase Maturity is within policy limits for instrument?	YES	YES
3. Wire Transfer of funds initiated by employee other than employee initiating investment?	YES	YES
4. Wire Transfer of funds carried out according to the terms of preformatted Wire Transfer letter?	NO	YES
C. PORTFOLIO MIX		
1. Is within Policy limits for category of instruments?	YES	YES
2. Total with a single issuer, other than government issues:		
a) Is within 10% of total portfolio;	NO	NO
b) For uninsured-uncollateralized issues, is within 5% of total portfolio?	NO	NO
D. TIME DEPOSITS - BANKS AND SAVINGS AND LOANS		
1. Bank or savings and loan is located in San Jose area (Santa Clara County)?	YES	YES
2. If not San Jose area, is it a minority bank?	NONE	NONE

APPENDIX B

SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF NOVEMBER 1985 AND DECEMBER 1985 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?	
	November	December
	<u>1985</u>	<u>1985</u>
3. Is a Contract for Public Funds Deposit on file?	YES	YES
4. Is a Waiver for Collateralization on file (for insured portion)?	YES	YES
5. For uninsured portion (over \$100,000), is the deposit with a bank or savings and loan with a Keefe, Bruyette and Woods rating of "B" or better, unless a "selected California bank" (Bank of America or Wells Fargo) rated "C" or better?	NONE	NONE
E. U. S. GOVERNMENT AGENCY ISSUES		
1. Is issue by one of the following: o Federal Farm Credit Bank; o Federal Home Loan Bank; or o Federal National Mortgage Association?	YES	YES
F. REPURCHASE AGREEMENTS		
1. Collateral is U.S. Treasury or Government Agency issue approved for purchase by Policy?	YES	YES
2. If overnight, collateral is equal to 100% of the repurchase agreement's face value?	YES	YES
3. If other than overnight, collateral is marked-to-market on a daily basis and maintained equal to 100% of the repurchase agreement's face value; or is sufficiently in excess of the repurchase agreements face value?	NO	NO

APPENDIX B

SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF NOVEMBER 1985 AND DECEMBER 1985 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?	
	November	December
	<u>1985</u>	<u>1985</u>
G. REVERSE REPURCHASE	NONE	NONE
H. BANKER'S ACCEPTANCES		
1. Is the issuer a bank or savings and loan with a Keefe, Bruyette and Woods rating of "B" or better, unless a "selected California bank" (Bank of America or Wells Fargo) rated "C" or better?	NONE	YES
I. NEGOTIABLE CERTIFICATES OF DEPOSIT		
1. Is the issuer a bank or savings and loan with a Keefe, Bruyette and Woods rating of "A" or better, unless a "selected California bank" rated "C" or better?	NONE	YES
J. COMMERCIAL PAPER		
1. Is this a domestic corporation?	YES	YES
2. Does this institution have the highest rating by Moody's or Standard and Poor's?	YES	YES
3. Does this institution have total assets of \$500,000,000 or more?	YES	YES
4. Does this institution have an "A" rating or higher on its own indebtedness other than its commercial paper?	YES	YES

APPENDIX B

SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF NOVEMBER 1985 AND DECEMBER 1985 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?	
	<u>November 1985</u>	<u>December 1985</u>
K. SAFEKEEPING-TREASURY PROCEDURES		
1. Person initiating release of securities is not same person initiating sale?	NONE	NONE
2. Written confirmation for release of City-owned securities was transmitted to Safekeeper within 24 hours of telephone instructions.	NONE	NONE
L. SAFEKEEPING - SECURITY/COLLATERAL HELD		
1. Collateral held by a Safekeeping Agent under the terms of a Safekeeping Agreement with the City?	NO	NO
2. For securities serving as collateral for a repurchase agreement which are not held by a Safekeeping Agent, are the securities held by a third party custodian with a Safekeeping Agreement with the City?	NONE	NONE
3. For uninsured/collateralized Time Deposits in a savings and loan, is collateral held by the Federal Home Loan Bank?	NONE	NONE

APPENDIX B

SUMMARY OF COMPLIANCE QUESTIONS FOR REVIEW OF NOVEMBER 1985 AND DECEMBER 1985 INVESTMENT TRANSACTIONS OF THE CITY AND THE REDEVELOPMENT AGENCY

<u>Compliance Question</u>	Based on Sample Review of Finance Documentation Did all Transactions Meet Criteria?	
	<u>November 1985</u>	<u>December 1985</u>
4. For uninsured/collateralized Time Deposits in a bank, is collateral held in the City's name in:		
a) The issuing banks' trust department, provided the bank has a Safekeeping Agreement with the City, or	NONE	NONE
b) In the San Francisco Federal Reserve Bank?	NONE	NONE
M. REPORTING		
1. Exceptions reported to Finance Committee?	YES	YES
<u>OTHER AREAS</u>		
1. Was sale necessary to meet cash needs?	NONE	NONE
2. Is documentation adequate to substantiate compliance?	NO	NO
3. Are control procedures functioning?	NO	NO

APPENDIX C
SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>REVIEW OF SEPTEMBER 1985 INVESTMENTS</u>	
<u>Recommendation #1</u> Treasury staff utilize MONEYMAX in managing the portfolio and making investment decisions by: running a portfolio profile daily or on each day when purchases, sales or maturities occur; and using the portfolio profile report in making investment decisions. (Priority 1)	Implemented
<u>Recommendation #2</u> Treasury staff insure that entry into MONEYMAX is timely and accurate by: entering transaction data on the date that the transaction occurs; running machine numbered, logged and dated batch reports for all entries; and reviewing batch reports for accuracy. (Priority 1)	Implemented
<u>Recommendation #3</u> Finance enhance staff's ability to utilize MONEYMAX by: providing comprehensive training for employees in the use of MONEYMAX; and preparing a simplified instruction manual on the use of MONEYMAX for Finance employees. (Priority 2)	Training will be on-going. A session occurred December 20, 1985. Instructions for MONEY MAX use are targeted for completion by April 1, 1986.
<u>Recommendation #4</u> Treasury staff advise Finance management of portfolio status on a timely basis by distributing a copy of the portfolio profile report in Recommendation #1 to the Treasurer, Chief of Accounting and the Finance Director. (Priority 1)	Implemented

APPENDIX C
SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>Recommendation #5</u> Treasury staff prepare revenue vouchers for maturities, sales and interest payments on the date funds are deposited or payment is received. (Priority 1)	Alternative implemented and accepted. Revenue vouchers are prepared on the day following receipt of funds.
<u>Recommendation #6</u> Treasury staff maintain documentation to verify information used each day in making investment decisions, including the portfolio profile report and all cash flow information. (Priority 2)	Partially implemented. A daily portfolio profile is maintained. Procedures for improving cash flow documentation are being implemented.
<u>Recommendation #7</u> Finance complete procedures regarding prequalification of financial institutions.	Dealer responses to Treasury requests for updated financial statements are being received. Treasury is developing procedures to evaluate financial condition. This recommendation is now incorporated in Recommendation #3 of the October Investment Report.
<u>Recommendation #8</u> Treasury document reasons for sales.	No sales have occurred since this recommendation.

APPENDIX C
SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>Recommendation #9</u>	
Accounting complete improvements in reconciliation procedures.	Improvements are nearly completed. Full implementation is expected in January. This recommendation is now incorporated in Recommendations #7 and #12 of the October Investment Report.
<u>REVIEW OF OCTOBER 1985 INVESTMENTS</u>	
<u>Recommendation #1</u>	
Finance comply with Policy requirements to execute formal safekeeping agreements with the City and Redevelopment Agency's Custodial Agents to assure that the City's interest in securities is adequately perfected. (Priority 1)	Draft agreement undergoing legal review. Execution of safekeeping agreements is anticipated by April 1, 1986.
<u>Recommendation #2</u>	
Treasury staff comply with Policy requirements to maintain collateral at 100% of the repurchase agreement's face value, marked-to-market value daily, or sufficiently in excess of the agreement's face value. (Priority 1)	Treasury is implementing procedures to utilize the MONEYMAX system to monitor repurchase agreement collateral.

APPENDIX C
SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>Recommendation #3</u> Finance comply with Policy requirements to establish procedures to evaluate and monitor dealer financial condition and execute formal master repurchase agreements and services agreements with dealers. (Priority 1)	Treasury estimates that procedures for evaluating dealer financial condition will be implemented April 1, 1986. A draft dealer services agreement which includes master repurchase provisions is undergoing legal review. Finance has targeted May 1, 1986 for execution of agreements pending dealer concurrence.
<u>Recommendation #4</u> Treasury establish guidelines for repurchase agreements which 1) allow substitution of securities only on an exception basis, and 2) limit the number of securities used as collateral. Treasury document reasons for exceptions to the guidelines. (Priority 1)	Treasury is updating the procedures which accompany the Investment Policy to include these and other new provisions. Targeted completion is April 1, 1986.
<u>Recommendation #5</u> Finance obtain clarification from the Private Sector Investment Committee regarding the issues of repurchase agreement collateral, issuer percentages, and financial institution qualifications. (Priority 2)	A meeting with the Committee will be scheduled in March 1986.

APPENDIX C
SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>Recommendation #6</u> Finance include in its Monthly Investment Report all investments which do not comply with Policy provisions. Finance should indicate which investments are subject to on-going review for potential sale. (Priority 2)	The City Auditor has requested that Finance provide written policy interpretations for use in the compliance reviews.
<u>Recommendation #7</u> Accounting ensure that safe-keeping receipts are promptly received and reconciled. (Priority 1)	Improvements in reconciling safe-keeping receipts are nearly complete.
<u>Recommendation #8</u> Treasury establish data entry standards to ensure the accuracy of MONEymax entry, including adequate issuer identification. (Priority 1)	Treasury is developing procedures. The target completion date is April 1, 1986.
<u>Recommendation #9</u> Treasury enter the dealer's name and securities held as collateral for repurchase agreements into the MONEymax system. (Priority 1)	Treasury is in the process of implementing procedures to enter repurchase collateral to MONEymax. Implementation is anticipated by the end of February 1986.

APPENDIX C
SUMMARY OF IMPLEMENTATION STATUS
FOR PRIOR RECOMMENDATIONS

<u>Recommendation</u>	<u>Status</u>
<u>Recommendation #10</u> Treasury document daily investment strategy and purchase decisions. (Priority 2)	Additional documenta- tion began in December. Additional review is required.
<u>Recommendation #11</u> Treasury segregate the functions of investing funds and receiving investment income. (Priority 1)	Treasury has implemented interim procedures which will be evaluated in future reviews.
<u>Recommendation #12</u> Finance establish additional procedures to ensure that controls are functioning and written verification of purchases and sales is complete and timely. Specifically, procedures need to be established to 1) monitor compliance with Policy provisions regarding release of funds or securities 2) provide for 24 hour preparation and mailing of confirmations 3) implement pre-numbered and controlled confirmation documents and 4) date stamp and reconcile dealer, safekeeping, debit and credit advices as received. (Priority 2)	Partially implemented. The Control Log for wire transfer of funds was properly initialed in November and December. Finance plans to amend the Investment Policy to allow three working days for transmittal of confirmations. Implementation of pre-numbered confirmations is targeted for July 1, 1986. Accounting is now date stamping all receipts and advices.